<u>Every Supreme Court Bankruptcy Discharge Decision</u>

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Archer v. Warner, 538 U.S. 314 (2003)

In Archer, the U.S. Supreme Court held that a bankruptcy court has the power to look behind the contractual language of a settlement agreement, including its release language, to determine whether the resulting debt reflects fraud that is dischargeable under Section 523(a)(3)(A) of the Bankruptcy Code.

The Archers (the purchasers of a company) sued the Warners (the sellers) in state court for fraud relating to the sale of Warner Manufacturing Company.[1] Approximately three years later, the parties resolved the litigation with a fixed-sum settlement that compensated the Archers for emotional distress and personal injury damages. The Warners paid $200,000 up front and executed a note for the remaining $100,000. In return, the Archers released the Warners "from any and every right, claim, or demand" that the Archers "now have or might otherwise hereafter have against" the Warners. The parties voluntarily dismissed the lawsuit with prejudice.[2]

The Warners filed for bankruptcy after failing to make the first payment on the note. The Archers initiated an adversary proceeding to challenge the dischargeability of the $100,000 debt as "money … obtained by … fraud" under Section 523(a)(3)(A). Leonard Warner agreed to a consent order that deemed his debt nondischargeable, but Arlene Warner did not.[3]

The bankruptcy court determined that the $100,000 debt was dischargeable, and the district court and Fourth Circuit affirmed. The Fourth Circuit reasoned that the settlement agreement and releases acted as a novation that replaced the fraud-based potential debt.[4] The new debt, it

[1] *Archer v. Warner*, 538 U.S. 314, 317 (2003).
[2] *Id*.
[3] *Id*. at 318.
[4] *Id*.

concluded, was contractual and therefore dischargeable.[5] The Supreme Court disagreed with the Fourth Circuit's novation theory.

The Court held that a settlement agreement with a release can amount to a debt for money obtained by fraud within Section 523(a)(3)(A). In doing so, the Court concluded that its precedent in *Brown v. Felsen*, 442 U.S. 127 (1979) and the Fourth Circuit's novation theory could not both be correct, so it relied on its own precedent.[6]

Brown's facts were identical except the debt resulted from a stipulation and consent order instead of a settlement and voluntary dismissal.[7] The *Brown* Court held that "the Bankruptcy Court should look behind that stipulation to determine whether it reflected settlement of a valid claim for fraud."[8] Apart from its precedential value, *Brown* articulated two points relevant to the Court's reasoning in *Archer*. First, *Brown*'s holding prevents contentious creditors from reducing their claims to bar further inquiries into the true nature of the debts.[9] Second, *Brown* pointed out that Congress amended the language of Section 523's coverage from "judgments" to "liabilities." The change reflected its intent to extend the nondischargeability statute's scope to its "fullest possible inquiry" regardless of the debt's form.[10]

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[5] *Id*.
[6] *Id*. at 320.
[7] *Id*.
[8] *Id*.
[9] *Id*. at 320–321.
[10] *Id*. at 321.

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